



**Paving the Way Forward for Rural Finance
An International Conference on Best Practices**

Case Study

Rural Financial Institutions: Start-Ups

PT Ukabima Case Study

By Maria C. Stephens
(Catholic Relief Services)

This case study was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

TABLE OF CONTENTS

Acknowledgements

Summary

List of Acronyms

I. Key Economic and Demographic Indicators

- A. Pre-1997 Financial Crisis Financial Indicators
- B. Post-1997 Financial Crisis Financial Indicators
- C. Demographic and Social Indicators

II. Background to Indonesia's Rural Financial System

- A. Colonial Period: 1860-1945
- B. Sukharno Period: 1949-1967
- C. Soeharto Period: 1967-1998
- D. The 1997 East Asian Crisis
- E. Post-Soeharto Period: 1999-Present

III. Characteristics of BPRs

- A. Similarities with BRI
- B. Differences from BRI

IV. Introduction to PT Ukabima

- A. Background
- B. Financial Base and Regulatory Oversight
- C. Ukabima Family Indicators
- D. Competition

V. Mechanics of Ukabima

- A. Products and Services Provided to BPR Network
- B. Selection of BPRs

VI. Results and Impact

- A. Innovation and Meeting Effective Demand
- B. Social Impact
- C. Links to Broader Economic Growth and Financial Sector Reform
- D. Sustainability

VII. Challenges Defined and Strategies Employed to Overcome Them

- A. Extending Agricultural Credit
- B. Institutional Sustainability and Competition
- C. Outreach, Training, and Education
- D. Ukabima Management Capacity

VIII. Policy and Donor Recommendations Based on Ukabima's Experience

- A. Innovations, Knowledge Transfer
- B. Lessons for Donor Community, Keys to Success
- C. Policy Recommendations for Donors with Regards to Start-ups of Rural Financial Institutions

Final Conclusions

Notes

Attachments

Bibliography

ACKNOWLEDGEMENTS

In March 2003 the author was graciously accompanied and assisted on field visits to Ukabima BPRs Arta Kencana and Kartasuro Makmur by Pak Rudy Pratseya, Director of PT. Ukabima, During this visit the author also met with senior BPR management, Dr. Sujarwo, Mssrs. Harry Wuryanto, Soenaryo, and Winardjono and their field staff.

The author received guidance and comments from the following individuals familiar with PT Ukabima and microfinance in Indonesia: Mssrs. Rudy Pratseya; Edmond de Capele, consultant and Ukabima Board member; Xavier Reille, CGAP (formerly a Regional Technical Advisor for CRS); Michael Frank, Country Representative, CRS/Indonesia; Muhota Kimotho, CRS Southeast Asia and Pacific Regional Technical Advisor; Tony Fernandes, Cordaid; Didier Thys, MIX (former Director of CRS' Small Enterprise Development Technical Unit); and Ms. Alka Couet, SIDI. Any errors or omissions are the responsibility of the author only. Thanks, as well, to CRS's Jennine Carmichael for her careful edits.

PT Ukabima Case Study Summary: Microfinance in Indonesia is as varied and colorful as the island's flora and fauna, languages and cultures. While its roots extend to the period of Dutch colonial rule, Indonesia's microfinance industry has developed and flourished due to indigenous innovation, unambiguous government and regulatory support, and a strong development agenda at both public and private sector levels. It is within this rich and supportive context that PT Ukabima was formed, and continues to maintain its standing as one of Indonesia's strongest financial intermediaries. A wholesale microfinance banking institution, Ukabima currently supports a network of 44 BPRs, or people's village banks, located primarily in Java and Bali's rural and peri-urban districts. Ukabima supports BPRs that offer financial services to individual clients and solidarity groups involved in a full range of economic activities, including agricultural enterprise. At both the Ukabima and BPR levels, management employs strategies that minimize the risks associated with such lending. Ukabima supports the BPR network through a unique integrated financial and technical assistance and training package, selecting partners that understand clients' needs and preferences, and managing the risk associated with agricultural credit lending.

Ukabima faces many challenges as it moves forward with its objective of assuming a leadership role of supporting socially responsible people's village bank associations on a for-profit basis. The post-1997 Asian financial crisis still impacts the overall economy; easy credit, subsidized loans and technical services extended to microfinance operations by both government and bilateral organizations distort critical market signals and erode a level playing field; and Ukabima's goal of attracting equity investors are a few of the major challenges facing this relatively young organization. Nonetheless, Ukabima has cleared its first major hurdles, and stands ready to provide policymakers and others in the microfinance field with some important lessons regarding managing risk associated with agricultural credit, and overall management of BPR associations in rural Indonesia.

LIST OF ACRONYMS

AVB – Algemeene Volkscredietbank

BI – Bank of Indonesia

BMMS – Bina Masyarakat Mandiri Sejahtera

BPR – Bank Perkreditan Rakyat

BRI – Bank Rakyat Indonesia

CRS – Catholic Relief Services

FSS – Financial self-sufficiency

IMF – International Monetary Fund

MAF – Microfinance Alliance

MF – Microfinance

MFI – Microfinance Institution

MIP – Microenterprise Innovation Project

MIS – Management Information Systems

PNM – PT. Permodalan Nasional Madani Civil National Capitalization, Ltd

PPI – Project Performance Indicators

ROE – Return on equity

SIDI – Societe d’Investissement et de Development International

USAID – United States Agency for International Development

PT UKABIMA CASE STUDY

I. Key Economic and Demographic Indicators

To understand fully Ukabima's place within Indonesia's microfinance sector, it is necessary to place its origins and progress within the broader context of MF development in Indonesia, and to understand the unique challenges to the industry posed by Indonesia's natural, social, and political environment.

A. Pre-1997 Financial Crisis Financial Indicators

From 1970 to 1996, Indonesia's economy showed a 7% growth rate, a relatively stable exchange rate, and an average inflation rate below 10 percent. The economy was rated as one of Asia's most successful. **Attachment 1** gives several of Indonesia's key financial indicators prior and subsequent to the 1997 crisis.

B. Post-1997 Financial Crisis Financial Indicators

From 1997 to 1999, Indonesia's economy showed sustained negative impact from the collapse of the banking system and other key financial institutions throughout Asia. The rapid deterioration of Indonesia's economy continues to pose challenges to the entire financial sector, including microfinance. It is important to note from this data that BPRs, including Ukabima's, continued to mobilize significant levels of savings and deposits throughout the financial crisis (**Attachment 2**).

C. Demographic and Social Indicators

Population and Health

Indonesia is a vast archipelago comprising over 13,000 islands that straddle both sides of the equator, with a geographic span of 2,000 km from north to south and 5,000 km from east to west. Such a vast expanse of human and natural resources poses unique political challenges at the national governance level, as well as operational challenges to microfinance managers. The current population of approximately 231 million lives on the islands of Java, Bali and Madura, which account for less than 10 percent of Indonesia's land territory. This results in a dense population distribution of about 1,000 persons per square km.¹ The current maternal and under-five mortality rates are 470/100,000 live births, and 45/1,000 live births, respectively (UNICEF, 2001). Life expectancy based on total population is about 67 years, and 71 years and 66 years for females and males, respectively (CIA World Factbook 2002). Relative to most developing countries engaged in microfinance, Indonesia's demographic and health conditions do not pose an immediate and obvious threat to the industry's success.

Cultures, Languages and Literacy

Indonesia's population is comprised of 366 ethnic groups with distinct languages, religions, and customs. The official language is Bahasa Indonesia, a modified form of Malay, while the most widely spoken dialect is Javanese. Indonesia's population is nearly 90% Muslim, with the remaining 10% comprised of Protestants, Roman Catholics, Hindus, Buddhists, and other religious minorities. Literacy, defined as a person's ability to read and write over the age of 15, ranks at nearly 84% for the total population, about 90% for males and 78% for females, based on 1995 estimates (CIA World Factbook 2002).

II. BACKGROUND TO INDONESIA'S RURAL FINANCIAL SYSTEM

A. Colonial Period: 1860-1945

The Dutch colonial period extended from the late 18th century, with the administrative unification of Indonesia under Dutch colonial rule, until 1945. While one could argue that the Dutch helped provide the foundation of Indonesia's current success with village banking and microfinance through the development of the Algemeene Volkscredietbank (AVB), the precursor of the Bank Rakyat Indonesia, the Dutch period is also characterized by social, political and economic systems that antagonized preexisting tensions between ethnic Chinese and *pribumi*, or indigenous Indonesians, and did little to promote broad-based education, both of which had negative impact on the country's early post-colonial development.

Throughout the colonial period, the Indonesian financial system comprised seven large foreign commercial banks, three of which were Dutch. Badan Kredit Desa, or village banks and granaries, provided small farmers an alternative to moneylenders. BRI, a national state bank that developed out of AVB in 1895, operated at the district level and, until 1968, primarily served civil servants. There were few financial services available to rural Indonesians outside of these large and relatively restrictive institutions.

B. Sukharno Period: 1949-1967

President Sukharno knit together a unified republic and based the new system on *Pancasila*, the five guiding principles of Indonesian government, rather than on any single religious or cultural system. However, with an incoherent political administration, an inefficient banking system, soaring debt and sustained hyperinflation, an agricultural sector unable to support the population, and leadership either unwilling or unable to control increasing poverty rates, Sukharno lost his political mandate. A violent coup in 1965 led to the installation of one of Sukharno's senior military leaders, and the start of a sustained period of economic growth and stability.

C. Soeharto Period: 1967 – 1998

The first task at hand during the early Soeharto period was to restore order and establish political stability, control inflation, and increase food production. It is not surprising, therefore, that the early stage of this period is characterized by interventionist policies aimed at the banking sector that were gradually relaxed once stability was restored.

Period of State Intervention: 1967-1983

Three interventions during the early Soeharto period had significant implications for subsequent MFI development: the establishment of regional and Bank Perkreditan Rakyat (BPRs); restrictions on foreign banks and targeted credit and ceilings; and BRI's evolution into the predominant financial institution in rural areas. In an effort to expand and deepen the financial system, regional banks were established by each of Indonesia's 27 provincial governments, and approximately 300 BPRs were established at the district level by 1970. At the same time, the Government imposed restrictions on the entry of foreign-owned banks into the banking system, including a ban on the issue of new licenses to foreign banks in 1969. In addition, the Government imposed targeted credit and ceilings as a way to stabilize further the macroeconomic conditions it inherited.

The Soeharto government's intervention in the financial system led to the predominance of the public sector in banking, which stunted both the expansion and deepening of the financial system. BRI, which benefited from much national support, became the predominant institution in rural areas. However, its services did not reach deep into the rural areas, nor did they serve the lower strata of economically productive clients involved in a wide range of activities, including agriculturally based enterprises.

Period of Financial Liberalization: 1983-1992

A confluence of endogenous and exogenous factors led to the gradual erosion of Indonesia's interventionist policies aimed at the financial system. This, in turn, led to a series of financial liberalization actions culminating in the 1992 Banking Act that paved the way for the rapid development of a broad range of financial institutions.

Starting in 1983 Indonesia began a gradual and consistent process of deregulation of its financial system, the major elements of which are listed as follows: In 1983 interest rate autonomy was given to all public and private banks, and the Bank of Indonesia dropped direct interest rate controls. In 1988, a distinction was drawn between "general banks" and "people's credit banks", or BPRs, with savings deposits regulations established for both. In 1990 BI withdrew most of its interest rate subsidies, and commercial banks were required to allocate a minimum of 20% of their portfolio to small banks, either directly or through BPRs. In 1992 the Banking Act summarized all prior deregulatory actions. Finally, in 1993 the geographic restriction on BPRs was removed, leading to an expansion of rural financial institutions beyond sub-district level and overall deepening of the microfinance market. The net result of liberalization was a deepening of the

financial system and a more rationalized rural banking system whose “rules of the game” were clearer and more transparent.

D. The 1997 East Asian Crisis

Weaknesses in governance and in the financial system, rampant corruption by the ruling family, collapse of the Thai bhat, and sluggish economic growth in Japan and Europe all contributed to the 1997 financial crisis. While the crisis spread quickly throughout East Asia, its impact was strongest and deepest in Indonesia. From the start of the crisis in June 1997 to June 1998 alone, the value of the rupiah fell from 2,450 to 14,900 against the dollar. The crisis exposed deep rooted structural flaws in Indonesia’s financial system and management which, combined with increasing public dissatisfaction with President Soeharto, led to his resignation in May 1998 and replacement by his Vice President, B.J. Habibie, whose presidency lasted for only one year.

E. Post-Soeharto Period: 1999 – Present

Indonesia is currently in a state of transition, still sorting out the mixed results of the long Soeharto regime and short-lived terms of both presidents Habibie and Wahid. The current president, Megawati Soekarnoputri, is a conservative nationalist with her father’s legacy as her apparent destiny. She enjoys popular support, and has the support of the military, both of which are critical for a stable political base. Much hope is placed in President Megawati’s ability to build the institutions that are necessary to prevent a repeat of the 1997 crisis and that are necessary to form the basis of democratic reform. The extent to which she succeeds within the remainder of her term, and the results of next year’s elections, will have profound implications for the continued success of microfinance in Indonesia. The exchange rate has remained relatively stable since 2000, (currently at 9,880 rupiah to the dollar), inflation is about 10 percent, and President Megawati has restored relations with institutions such as the IMF. Currently, prospects are good that the environment will remain conducive for microfinance.

Alongside Indonesia’s political uncertainties, it remains to be seen what real financial impact the crisis has had on BPRs. Already some changes are taking place in the BPR system as a result of the financial crisis. Specifically, in 1999, new Bank of Indonesia regulations increased capital requirements for opening BPRs or branches by 10 times, to Rp 500 million (more than three times, when adjusted for inflation). This could create a third type of bank alongside commercial and rural people’s banks, with BPRs split into medium- and small-sized units (Robinson 2002, p.103).

III. CHARACTERISTICS OF BPRs

Today there are nearly 9,000 generic BPRs in Indonesia. As mentioned earlier, the establishment of MFIs—including BPRs—and the outreach of existing financial institutions to the poor were results of two significant government actions: first, the deregulation of interest rates in 1983 that led to a rapid rate of savings and a plethora of financial innovations; and second, the bank deregulation of 1988 that encouraged the

rapid establishment of BPRs at the rural sub-district level and the transformation of small institutions into rural formal sector banks. In addition, the 1988 *Pakto* act established the distinction between “general commercial banks” and “people’s credit banks,” or BPRs. In order to understand Ukabima’s operations, it is important to understand some essential distinctions between bank types. As BRI is the largest, and most well known of the general bank type, it will be used as a proxy for this bank type in drawing comparisons.

A. Similarities with BRI

Both BRI and BPRs require that clients be screened for their ability to provide physical collateral, such as land titles, regular salaries, and productive capital as part of the loan screening process. In addition, both bank types staff their banks with large and professional staff capable of evaluating and monitoring applications and client projects.

B. Differences from BRI

Unlike the relatively newer BPRs, BRI desa units enjoyed government support and benefited from years of experience since the 1970s, and even earlier from AVB lessons. This gives BRI certain advantages when competing with BPRs for clients.

But while BRI enjoys certain advantages given its long history in Indonesia, BPRs are establishing their own unique identity through which they are continuing to develop a market niche. For example, many BPRs have cultivated an image of “quality service providers” by having new and spacious offices, large and well-trained staff, a customer-friendly atmosphere, and a wide range of services, including mobile loan officers. Several BPRs show sensitivity to clients’ cultural norms and customs, and design some products to accommodate these. Some BPRs offer savings to clients wanting to finance trips to Mecca, or mark other significant religious holidays and customs. Others have adopted more broad-based “Islamic principles,” such as a prohibition on fixed, present interest rates, and sharing profits and losses with clients. By adopting Islamic principles, rural banks have earned the confidence of large numbers of clients and thus mobilize a large volume of savings necessary to build up liquidity and reserves (Case Study, p. 18). And because they work at the sub district level, BPRs develop a more personalized relationship with clients that helps them build character profiles necessary to determine client suitability for loans.

Finally, unlike BRI, some BPRs are organized into networks linked with approximately five commercial banks. BPRs working within networks enjoy economies of scale in training and technical assistance. Moreover, they can utilize resources efficiently within the network by mopping up excess liquidity in one bank and shifting it to another bank in need of extra reserves. While networks can help increase efficiencies, BPRs are still, in general, characterized as lacking in good governance, having few economies of scale, and having weak systems and operational capacity compared to BRI desa units.

IV. INTRODUCTION TO PT UKABIMA

A. Background

PT. Usaha Karya Bina Mandiri (Ukabima), translated as “Self Reliance Corporation”, is a wholesale financial intermediary formed in 1996 by Catholic Relief Services, a U.S.-based relief and development organization, with the financial and technical support of the U.S. Agency for International Development and the Societe d’Investissement et de Development International (SIDI). Ukabima is a limited liability company that provides capital and technical services to a network of 44 BPRs throughout Java and Bali (see **Attachment 3** for organizational chart). Ukabima works with the network as a shareholder, lender, and operational partner by supporting large-scale microfinance, namely savings and credit services for economically active low-income people in different occupations, including, but not restricted to, agriculturally based enterprises. The BPRs comprising the Ukabima family extend both individual loans, and group loans through a cooperative, with women comprising the majority of clients.

Ukabima’s national partners include the following: Nadhlatul Ulama, the largest Islamic organization in Indonesia, which manages three BPRs with Ukabima; Yayasan Social Bina Sejahtera, a Catholic NGO in Central Java which, along with Ukabima, is a shareholder of BPR BMMS; Yayasan Swadaya Membangun, a local Islamic NGO whose total BPR base cooperates with Ukabima; and the Association of National BPRs and Bank of Indonesia. Ukabima’s partners include: USAID, Societe d’Investissement et de Development International (SIDI), CRS’ Microfinance Unit, and the Microfinance Alliance (MAF), a financial institution developed in cooperation with CRS and Cordaid that provides technical assistance and loan capital.

B. Financial Base and Regulatory Oversight

Ukabima’s current technical and credit extension to the BPRs works through the Microfinance Alliance Fund (MAF), a financial institution developed through a strategic partnership between CRS, Cordaid, and SIDI. Ukabima is owned by three shareholders and has oversight through a Board of Directors and Investment Committee. Ukabima is not registered as a bank or non-bank financial institution as its current authorized capital of Rp 15 bn does not meet the required amount of Rp 50 bn (\$5.65 mn). Ukabima is working towards raising sufficient capital to register as a non-bank financial institution, so that it can enjoy a more favorable tax status.

In addition to seeking non-bank financial status as part of its long-term strategy, Ukabima has set up its own BPR, BMMS, and will set up two more. These units generate a high return whose profits can be used to capitalize the network’s operations. In addition, Ukabima continues to work with the MAF to attract equity investment into the Fund to support the BPR network’s on-lending and technical operations.

Attachment 4 shows a comparison of Ukabima’s performance from 2001-2. For the BPRs extending individual loans, the number of borrowers is over 57,000 and savers is

nearly 142,000. The loan portfolio is over \$2.2 mn, and savings level is nearly \$14 mn. Average loan size is \$385, and average savings account is \$98. For the Kusuma group banks, the number of members/borrowers is nearly 5,000.² Loan and savings levels are about \$138,000 and \$26,000, respectively. Average loan size is \$29, and savings is \$6.

C. Ukabima Family Indicators

Total borrowers and savers are 51,470 and 130,511, respectively. The percentage of women borrowers is 40% (note: collateral is typically in the name of the husband, so this figure is underestimated). The average loan size is \$363, with arrears over 90 and 180 days at 4% and 2%, respectively. The consolidated loan portfolio is valued at \$18.6 mn, consolidated savings and time deposits at 11.5 mn, consolidated profit at \$.8 mn, consolidated net worth at \$3.0 mn, and consolidated return on equity (annual basis) at 36%. With 89% of BPRs borrowing from Ukabima having a profit of greater than 20% its equity, and 76% with a profit of more than 30% of its equity, the institutions are strong (**Attachment 5**).

D. Competition

PT. Permodalan Nasional Madani Civil National Capitalization, Ltd. (PNM) is the major competitor Ukabiima faces in the wholesale institution industry. More will be discussed about Ukabima's competition in the "Challenges with Project Implementation" section.

V. MECHANICS OF UKABIMA

A. Products and Services Provided to BPR Network

Ukabima works with the BPRs in three ways: as a shareholder, lender³, and operational partner, with the bulk of its current work falling in the second category (**Attachment 6**). With the shareholder model, Ukabima positions itself as majority shareholder by investing in 51% of the outstanding shares and provides loans, subordinated loans, and share convertible loans to BPRs. BPR members receive human resource and management training; assistance in preparing work plans, financial statements, and performance analysis. Ukabima also meets regularly with BPR directors.

B. Selection of BPRs

BPRs join the Ukabima system through one of two ways: either Ukabima undertakes a desk assessment of a BPR and solicits its participation, or a BPR approaches Ukabima to join, having heard about the wholesaler through the media or referral. During the first 3.5 years of operation (1997-2000), the contacts resulted mainly from Ukabima recruiting BPRs. Of late, contacts come mostly through BPR referrals. Once contact has been made and the BPR is interested in joining the Ukabima system, the BPR begins a three-stage evaluation process:

Stage-0: The objective of the S-0 evaluation is to ensure that the BPR shares the same vision and mission with Ukabima, has a sound reputation within its community, and a strong Board of Directors and management structure are both in place and functioning. This process is undertaken to prevent Ukabima's dealing with partners aiming only for profit or social impact, or those who may be looking to "legalize" money-lending practices.

Stage-1: The S-1 evaluation assesses BPR business prospect (market size, competition, demand for service), management capacity (education, experience in banking, leadership style), operations (system and procedures, MIS, accounting), risks (asset and liability management, leverage, liquidity, financial efficiency, productivity), product and services (savings/credit, product quality), and collateral appraisal.

Stage-2: The S-2 evaluation is an audit to ensure that checks and balances are in place.

Ukabima's Business Development, Audit, and Rating managers undertake the assessments, while the Ukabima Internal Credit Committee and Investment Committee make approval decisions at each stage based on majority vote.

VI. RESULTS AND IMPACT

A. Innovation and Meeting Effective Demand

Ukabima offers a package of technical training and assistance and loan services to its BPR clients that is, in itself, an approach unique among wholesalers in Indonesia. This integrated approach allows for frequent contact between Ukabima and BPR clients that is mutually reinforcing to the objectives of all the institutions. In addition, Ukabima has developed an MIS software package, MFI-2000, that is used throughout Ukabima and the BPR network to generate monthly Bank of Indonesia reports. Despite having established a market niche, Ukabima faces strong competition in the field. For example, PNM, a state-owned APEX company, currently provides a subsidized software system for BPRs in addition to loans. PNM also provides a 50% subsidy for the training it gives to the BPR association, Perbarindo. Despite the competition, Ukabima believes it can compete with other wholesalers because the training, software package, and supervision and audit system it offers have been tested over the past six years, while others are still in the process of development. Nonetheless, Ukabima remains alert to the possibility that other wholesalers may quickly close the gap given their larger resource base; currently PNM has 100 times the asset base and 200 times the capital base of Ukabima.

B. Social Impact

In compliance with a USAID MIP grant, Ukabima hired a consultant in 1999 to conduct a survey of the social impact made through the BPR network. Management plans to undertake a subsequent survey because it believes the results from the 1999 survey are distorted due to two factors. First, Ukabima was still in the early stage of operation when the survey was undertaken and was at the start of learning curve. Second, the full impact

of the 1997 financial crisis showed up in the BPR network by mid-1998. During that period, most of Ukabima's BPRs slowed down operations in order to avoid contagion risk from the crisis. This could distort the impact assessment of overall performance.

C. Links to Broader Economic Growth and Financial Sector Reform

Consolidated financial reports of the 44 Ukabima BPRs show that Ukabima's loans contribute about 10% of total loans disbursed by BPRs. At the same time, the Rp191 bn loans disbursed by the 44 Ukabima BPRs contribute only 3% towards the approximately Rp 6 trillion loans disbursed through the entire BPR industry. And while the value of loans in rural financial institutions as a share of total loans in the financial system was about 2.1 percent in 1995, Ukabima's contribution to the entire financial industry in Indonesia is small (Robinson 2002, p. 109).

But while Ukabima's contribution to the financial system expressed in terms of liquidity volume may be small, Ukabima's support of social-minded BPRs contributes towards broader economic growth objectives and financial sector reform in other ways. First, Ukabima's BPRs, like BPRs in general, serve a population niche that was not being served through the BRI unit desa system. The growth of rural BPRs has led to a deepening of the financial system into the otherwise underserved rural regions. In addition to providing marginalized populations with an alternative to usurious interest rates, Ukabima's BPRs provide technical assistance and training to clients to support optimal usage of loans. Finally, Ukabima's BPRs contribute to financial sector reform by supplying a channel through which savings can be mobilized and recycled in rural areas, while providing a commercial interest rate and protection to savers.

Finally, evidence within Ukabima corroborates a more generalized observation by others regarding the interaction of savings to loan performance, namely that the higher the share of savings in BPRs to total assets, the faster the growth, the higher the profitability, and the better the loan performance within the BPR (Robinson 2002, p. 123). While BPRs are successful in mobilizing savings (not term deposits), their cost of funds will be lower, and therefore the BPR will be able to enjoy a higher net interest margin, which will eventually lead to a higher return on equity and return on assets.

D. Sustainability

Ukabima's sustainability needs to be assessed at both the wholesale and retail levels. **Attachments 4, 5 and 7** list key sustainability data at both levels.

Sustainability at the Ukabima BPR Level

The BPRs supported by Ukabima follow the typical BPR pattern of reaching operational self-sufficiency after approximately 15-18 months of operation. In terms of efficiency, **Attachment 7** shows Ukabima's average BPR performance. The figures show that the Ukabima BPRs pay a cost of funds that is above the rate of inflation, meaning that the BPRs have already compensated the savers/depositors with a decent premium. The

return on equity also shows that, even when inflation adjustment is computed on the equity, the BPRs yield a high return of between 10-27%.

Sustainability at the Ukabima Wholesaler Level

Attachment 4 is a table of key indicators showing the performance of Ukabima at the wholesaler level. Ukabima's current performance levels indicate strong overall performance and prospects for sustained viability.

VII. Challenges Defined and Strategies Employed to Overcome Them

A. Extending Agriculture Credit

Ukabima supports BPRs serving primarily rural or semi-urban populations. As a result, some Ukabima clients are either directly, or indirectly, involved in agriculturally based enterprise. However, the portion of agricultural loans relative to the entire portfolio is not significant (**Attachment 8**). One Ukabima BPR, Artha Kencana, does extend a significant level of agricultural credit and has developed an agricultural loan model, similar to the AVB model, which is discussed below:

Management Structure: Loan officers must have an educational background in agriculture or be farmers themselves. They must be well trained to assess capital needs for every single crop on an annual basis (rental of rice field, types of crops: rice/rice/rice, rice/rice/soybean, rice/rice/corn). They must be able to make projections on the production of crops (i.e., second rice crops will decrease to a level of 15-25% of the first crops) and finances to determine if the cash flow is sufficient to repay the loan. Loan officers must engage in a working relationship with government agriculture officers to develop their expertise in issues related to agricultural production. Finally, loan officers must be knowledgeable in the precise timing of the entire farming process in order to collect payment of principal at harvest time.

Policy Structure: The farmer/debtor should have complementary employment (market vendors, wage worker, handicraft) to ensure that sufficient cash flow is generated at the household level to pay the monthly interest rate. The term for agricultural loans is one year; principal repayment is based on seasonal crop harvest time (mostly every four months), while interest is paid monthly. The BPR encourages early principal installment repayment. The loan size is given based on the financial assessment of that particular season to avoid overextending loans in the local market. The agricultural loan should be covered by collateral (land certificate or lease agreement of rice field that enables the BPR to have first right of crops). Finally, the loan is disbursed at the optimal timing for crop production (i.e., when the farmer needs to buy fertilizer or seeds, or when s/he needs to pay for labor or equipment).

Additional Services: Through a Farmer's Association established and maintained by the BPR, the BPR introduces farmers to other BPR customers who provide/sell agriculture-related business. Arta Kencana's Managing Director plays a leadership role in the

farmer's forum that was developed as an information-sharing forum for both farmer clients among one another, and between the clients and BPR management.

Education at Points of Disbursement: Prior to disbursement, clients are advised that loans are an opportunity to expand their businesses, and default closes the door to future loans. After disbursement, loan officers make immediate site visits to ensure appropriate usage of credit, and make regular follow-up visits to ensure the same.

Innovations in Recovering Loans: For all delinquent clients, the loan officer reassesses the client's business to determine the real cause of delinquency. In the event of natural calamity, the BPR, with Board approval, may reschedule or even refinance the loan. Hard evidence is needed to support such a request. Officers expect clients to seek assistance from extended family members and possibly the village head. Execution of collateral is a last, and difficult, resort, particularly if the collateral is a land certificate and the value is over two times that of the loan. While the BPR, as a formal bank, has a legal right to execute collateral, taking such action may jeopardize its reputation within the community. In most cases, the client will take the action of selling the land to pay off the loan. To avoid delinquency, a BPR loan officer typically visits clients at harvest time and accompanies them to the rice miller, where the farmer is paid for the harvest.

Product Diversification: Arta Kencana segregates loans into consumption and working capital loans. Management is able to track arrears rates on both types of loans, and assess from this information the potential risk of default. This segregation precludes a farmer from taking out a consumption loan for use in a business activity.

B. Institutional Sustainability and Competition

While they are still sorting out the impact of the 1997 Financial Crisis, BPRs in Indonesia continue to benefit from government support, particularly from the Bank of Indonesia. One BI initiative supports BPR associations and develops a training certificate to ensure that practitioners within the industry uphold uniform standards. BI is also facilitating the linking of commercial banks with MFIs, including BPRs. In the past year, commercial banks have been very receptive to this program. However, both government and bilateral initiatives extending MF loans with lower rates and larger sizes render the loans extended through Ukabima's BPR system less attractive. While such support can help microfinance institutions, it also sets up unique challenges to wholesalers like Ukabima that work on a for-profit basis, and that take their cues from market signals of supply and demand within the marketplace.

Alongside having to compete with subsidized competition, Ukabima, as a company committed to providing financial services to the poor, carries implicit costs that more generalized MFIs and banks do not carry. First, Ukabima's measurement standards go well beyond the financial by including social, or "soft" indicators. This makes the decision-making process slower, as impact is more difficult to quantify and assess. Second, Ukabima's tax liabilities and selling price are relatively higher compared to PNM and commercial banks, while its real income is less. Finally, as a wholesale

institution, Ukabima is not allowed to mobilize savings, which limits its capacity to leverage its equity and lending capacity.

While Ukabima offers a unique integrated financial services and training package to BPR clients, it faces competition from both private and public sector sources. In response to the competition, Ukabima has undertaken a customer service survey to learn what customer expectations are, and how they can best respond with appropriate services. In addition, Ukabima continues to refine its software product so that it provides a competitive alternative to other packages (such as MicroBanker) with a strong technical support base.

A basic weakness of all BPRs compared to other MFIs concerns outreach. Since most (if not all) BPRs are set up as for-profit banks, most BPR management concerns itself less with reaching more clients so long as the BPR generates sufficient return on equity. (The current ROE in the Ukabima network is between 30-40%.) BPRs, including those in the Ukabima network, may need to focus on continued outreach as a means to secure a larger client base and liquidity pool.

Ukabima's prospects for sustainability will be a function of both the strength of the underlying BPRs, Ukabima's management strengths, and the extent to which the wholesaler itself can attract investment to support it after its current donor-based support has ended. In addition, Ukabima will need to continue to develop innovative products to attract clients in a competitive market. Finally, Ukabima will need to compete effectively against both private sector wholesalers, and government initiatives.

One strategy Ukabima is employing is to commercialize some of its technical assistance. In addition to the 45 BPRs it covers, Ukabima has exposure to over 100 BPRs due to its assessments prior to loan disbursement. This gives Ukabima broad exposure to many BPRs. Ukabima will begin to charge for technical assistance for both BPR and non-BPR clients throughout this broad base of BPRs.

Second, Ukabima will continue with its plan to start up three BPRs that will become self-sufficient within 18 months, and whose profits can be used to support Ukabima's lending operations. Equity investment through its own BPRs carries a promise of a return on equity of between 35-40% within 16-18 months, based on overall prior BPR performance. In addition, Ukabima will have better control for outreach to the poor through its own BPR. Its experience thus far with BMMS (the first BPR founded by Ukabima) shows that Ukabima is able to demonstrate greater outreach to more clients compared to other BPRs with comparable size of assets and portfolio. Moreover, Ukabima will be able to benefit from the leveraging of savings and commercial bank loans through its own BPR, which it cannot otherwise enjoy.

Finally, Ukabima will continue to work with the Microfinance Alliance Fund to attract equity investors to provide Ukabima with loan capital for on lending to the BPRs.

C. Outreach, Training, and Education

BPRs aim to bring reasonably priced financial services closer to customers, on a privately owned, for-profit basis. Ukabima's BPRs are no exception in this regard. However, because Ukabima has a mission to serve the poor, it faces the added challenge of maintaining high levels of financial performance while reaching out to more clients, and inherently risky populations, such as those engaged in agricultural enterprise.

The largest single challenge facing Ukabima and its underlying BPR system is to hire good managing directors willing to work in such small companies, to train loan officers, and to utilize a solid MIS. If each of these elements is in place at both levels, then the BPRs should be able to reach operational sufficiency quickly and tap into the continuous demand for BPR services. However, because Indonesia's BPRs are not as highly capitalized as their Latin American equivalents, for example, they will always be subject to economic slowdowns or internal management issues and will, therefore, require permanent and continuous follow up by Ukabima management. Ukabima makes monthly follow up visits to its BPR clients and can ask for a total immediate repayment of its loan, enforcing the special covenant attached to all Ukabima loans when arrears are above 7% of total portfolio, before selling the mortgage hold as guaranty.

D. Ukabima Management Capacity

While Ukabima's management experience thus far has been to manage wholesale operations, it will need to continue to develop its capacity to attract and manage equity investments into its operations. In addition, Ukabima will need to continue to develop its internal resources to manage retail business through the BPRs it is establishing itself, which is a skill set different from that used to monitor pre-existing BPRs. Finally, although commercial technical assistance is a new part of its overall service structure, Ukabima has much experience developing training modules for BPRs, conducting and facilitating training workshops, providing audit and rating services, and developing and implementing software systems for BPR operations. What Ukabima will need to continue developing is the commercialization side of this venture through the process of developing marketing and sales strategies for this new line of business.

VIII. POLICY AND DONOR RECOMMENDATIONS BASED ON UKABIMA'S EXPERIENCE

A. Innovations, Knowledge Transfer

Ukabima provides financial services, training and technical assistance to Ukabima network clients. This ensures a uniform approach to service delivery and dissemination of a standardized product. In addition, Ukabima reduces its training costs by providing training through a network. Finally, individual BPRs have set up knowledge transfer mechanisms to address unique issues within their unit. Specifically, BPRs facing significant levels of risk from agricultural lending have established Farmers' Associations that act as information clearinghouses and conduits for disseminating information flow from the wholesaler to retailer level, and among the farmer clients themselves.

B. Lessons for Donor Community, Keys to Success

Ukabima's BPRs have a dual responsibility of reaching financial sustainability and serving poor clients. In order to do both effectively, the BPR should work to reach financial sustainability level 3 (**Attachment 9**) before venturing to extend loans and services to riskier groups (as in the Kusuma group lending model) and the agricultural sector, where cash flow is seasonal. The donor/investor should have a clear understanding of the above business model. If the BPR is not extending service after 1-2 years, it should be shut down. This may prove difficult for BPRs upholding social and financial goals.

The focus of wholesale management should be as follows: First, reach financial self-sufficiency within the first or second year. Second, mobilize sufficient savings and deposits in order to have a base of liquidity and sufficient loan loss reserves. Finally, operate efficiently. While these are appropriate measures for any MFI, it is strongly recommended that BPRs are sustainable within a maximum of 2 years. Starting in year 3, the BPR should make a measurable commitment towards delivering its services to the poorest and to those engaged in the agricultural sector. A regular Project Performance Indicators (PPI) assessment of non-financial performance is applicable after the third year.

C. Policy Recommendations for Donors with Regards to Start-ups of Rural Financial Institutions

1. Promote BPRs that reach financial sustainability by the second year of operation at the latest. Weed out those that cannot reach this standard as these poorer performers can drag down overall network performance.⁴ Within the first two years, BPRs should: reach financial sustainability; mobilize sufficient savings and deposits; and learn to operate efficiently. Starting in year 3, the BPRs should make a measurable commitment towards delivering services to the poorest and to the agricultural sector. A regular assessment of non-financial performance is applicable after the third year.
2. Find a niche, promote it actively, and stay ahead of the competition. In Ukabima's case, it provides a unique integrated package of financial services and technical assistance and training.
3. Work with and through implementing partners who are sensitive to their clients' cultural needs and preferences. For example, consider offering loans during times of the year when clients may need funds for particular religious activities.
4. Acknowledge and plan for the unique risks associated with lending to clients engaged in agricultural-based enterprises or activities. Set up support and information networks, like the Farmers' Association in Ukabima's BPR Arta Kencana, that work to gather and disseminate information that will help farmers procure cheaper inputs and plan for exigencies as they work to repay their loans. Time visits to clients that

coincide with crop harvest, and ensure that clients have sufficient household resources to balance off the risks of single crop enterprise.

Final Conclusions: Through careful selection, monitoring, and training of BPR clients, Ukabima has created a sustainable network of rural people's banks. Ukabima contains much of the risk inherent to agricultural lending by: promoting strong BPRs and weeding out weaker ones; offering a unique package of financial services and training; working with partners who are sensitive to cultural needs of clients; and establishing farmers' information networks as a way to gather and disseminate information that helps to minimize the risks associated with agricultural lending. Assuming that Indonesia's economy continues its upward trend—particularly within the financial sector—and political leadership establishes structures that can absorb the types of shocks that brought on the 1997 financial crisis, Ukabima can continue on its path to become a major wholesale microfinance lending institution in Southeast Asia.

Notes

¹ Indonesia's population density actually benefits microfinance operations by reducing operational costs and increasing both savings and deposit rates for the individual BPRs.

² In addition to providing individuals loans, Ukabima's BPRs deliver loans to the poorest without fixed assets collateral through the group lending methodology Kredit Kusumu. Kredit Khusus Untuk Masyarakat Miskin tanpa Agunan is a special loan window for those lacking collateral. Ukabima is proactively working to promote the Kusuma product line among the "Ukabima family" of BPRs. If replication is successful, this model has the potential to spread extensively throughout Indonesia and contribute to poverty alleviation alongside the BPRs that contribute more to economic growth.

³ Ukabima currently extends loan capital to the BPR network within the range of 18-20 percent (annualized), and the BPRs on lend at a rate of approximately 24 percent, maintaining a fairly constant spread of 4 percent.

⁴ This triage approach to BPR management mirrors closely the approach currently taken within the general Indonesian banking community. One of the key features of post-1997 banking reform includes closing down weak performers as a way to restore confidence in the financial systems and restore channels of credit. For a good review of post-1997 banking reform policy in Indonesia, see "The Boom, Bust, and Restructuring of Indonesian Banks" by Mari Pangestu and Manggi Habir.

ATTACHMENT LIST

1. Pre- and Post 1997 Financial Crisis Indicators for Indonesia
2. Consolidated Savings Performance for PT Ukabima
3. PT Ukabima Organizational Structure
4. Ukabima Performance Comparison: 2001-2002
5. Ukabima Family Indicators
6. Ukabima's BPR Structure
7. Ukabima Family BPR's Average Performance
8. Summary of Ukabima Questionnaire
9. PT Ukabima's Recommendations for and Calculation of Financial Sustainability Measures for BPRs

ATTACHMENT 1

PRE- AND POST-1997 FINANCIAL CRISIS INDICATORS FOR INDONESIA

1. Ratio of M2/GDP showing rate of change in time deposits 1982: 18 percent 1988: 30 percent	2. GDP annual % change, in constant 1993 prices 1994: 7.5 1995: 8.2 1996: 7.8 1997: 4.7 1998: -13.0 1999: 0.3
3. Domestic Demand as a percentage contribution to GDP growth 1994: 9.7 1995: 11.7 1996: 7.8 1997: 6.9 1998: -18.0 1999: -2.5	4. Net Export as a percentage contribution to GDP growth 1994: -2.2 1995: -3.5 1996: 0.0 1997: -2.2 1998: 4.8 1999: 3.0
5. Inflation 1994: 8.5 1995: 9.5 1996: 7.9 1997: 6.6 1998: 58.5 1999: 20.4	6. GNP annual percentage change, in constant 1993 prices 1994: 8.7 1995: 7.8 1996: 7.9 1997: 4.1 1998: -16.5 1999: 2.0

Sources: Inflation data taken from the Asian Development Bank, *Key Indicators 2002*

Other data provided by the Indonesian authorities, and assembled by the IMF, presented in IMF Staff Country Report No. 00/133, October 2000

ATTACHMENT 2

**CONSOLIDATION SAVINGS PERFORMANCE
PT. UKABIMA**

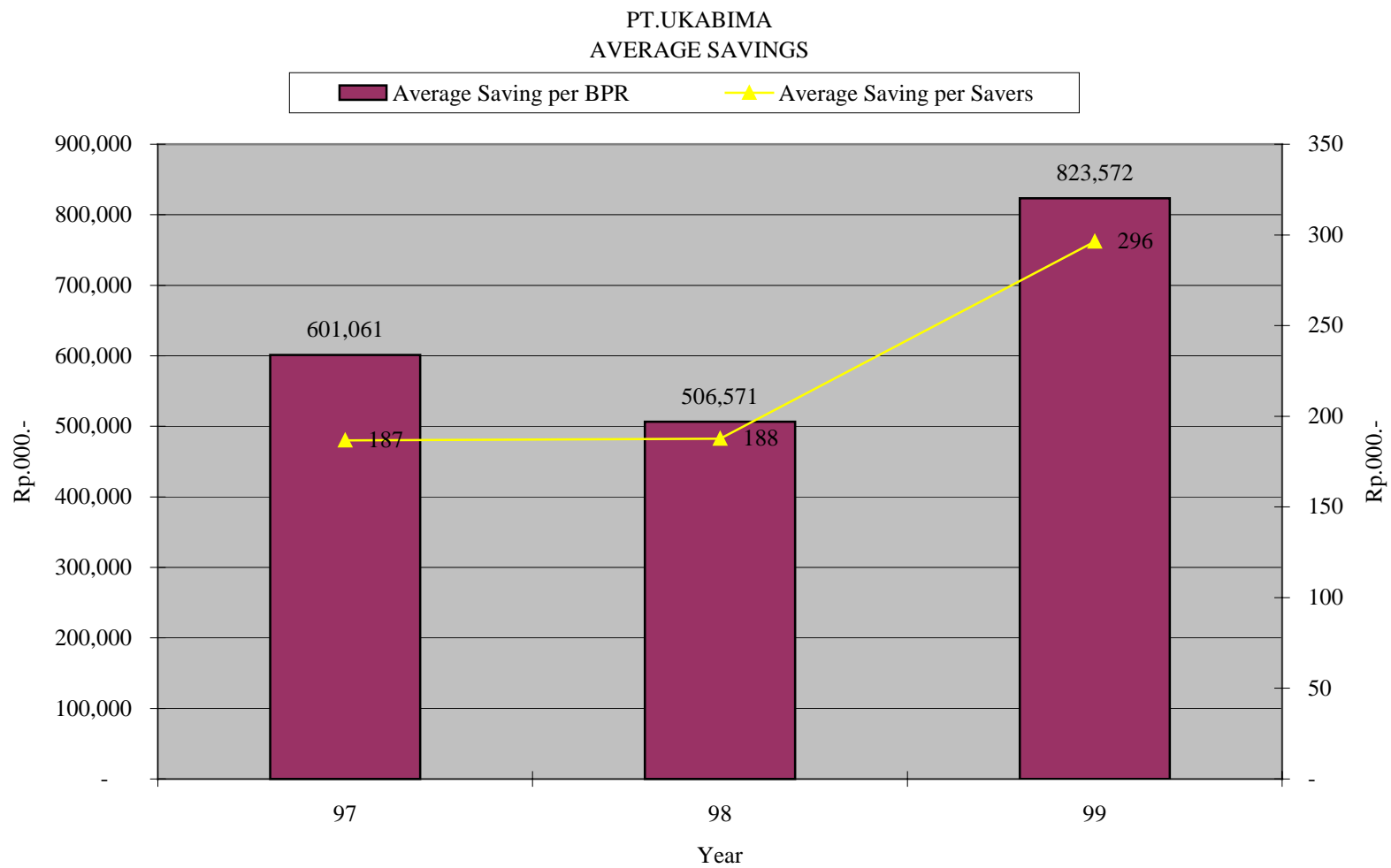
PERIODS ENDING 1997, 1998, 1999

	97	98	99
Savings and Deposit	3,606,365	7,092,000	14,000,725
# BPR	6.00	14.00	17.00
# Savers	19,322	37,791	47,255
Average # Savers per BPR	3,220	2,699	2,780
Average Saving per BPR	601,061	506,571	823,572
Average Saving per Savers	186.65	187.66	296.28

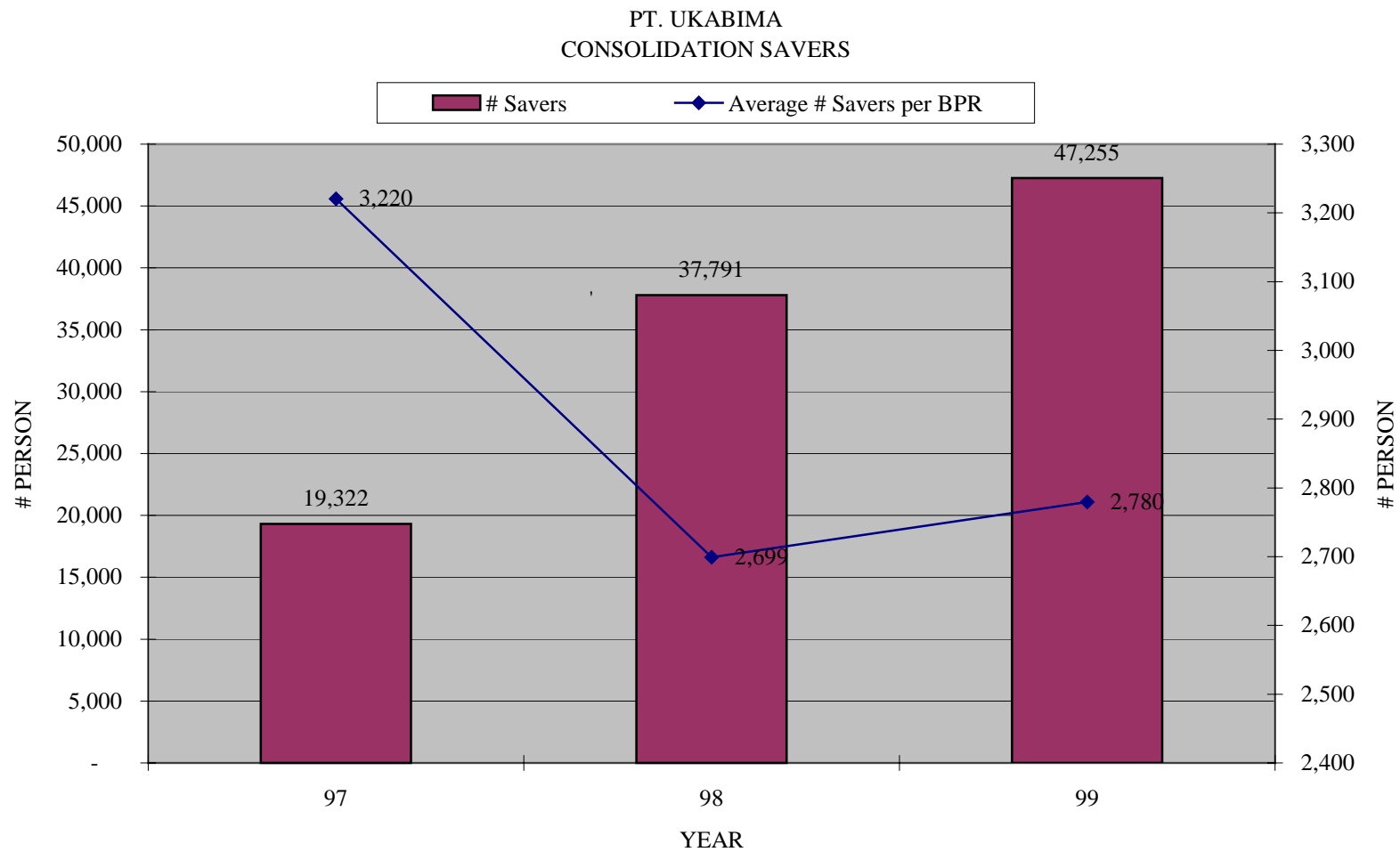
	97	98	99
Average Saving per BPR	601,061	506,571	823,572
Average Saving per Savers	187	188	296

	97	98	99
# Savers	19,322	37,791	47,255
Average # Savers per BPR	3,220	2,699	2,780

ATTACHMENT 2

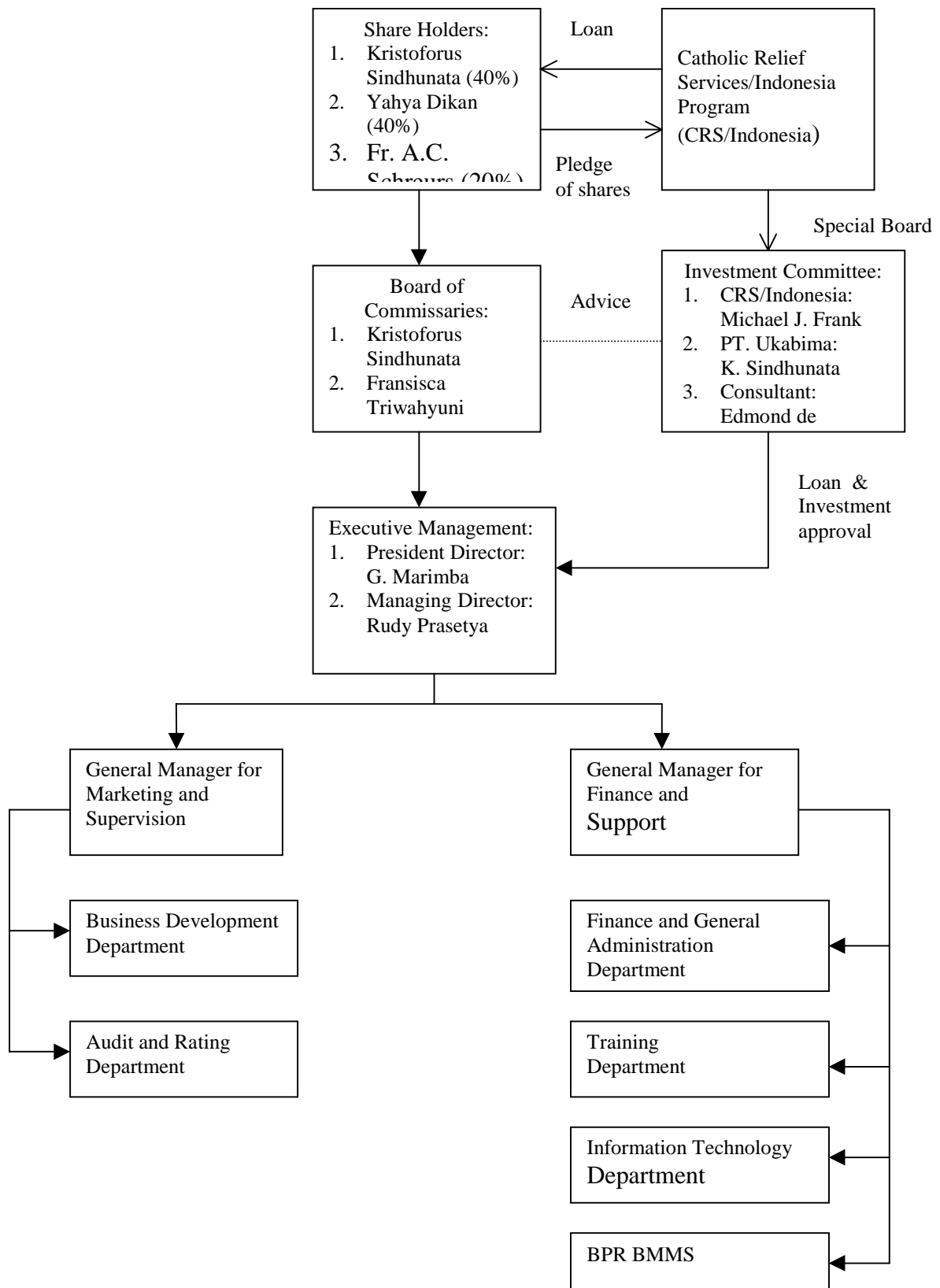


ATTACHMENT 2



ATTACHMENT 3

PT. UKABIMA ORGANIZATION STRUCTURE (2001-2003)



ATTACHMENT 4

UKABIMA PERFORMANCE COMPARISON 2000 – 2001

FINANCE	2001	2002	Var (unit)	% Var	In US Dollar	
					2001	2002
Assets (Rp billion)	19.93	27.97	8.05	40%	2,303,932	3,233,990
Portfolio (Rp billion)	14.18	19.70	5.52	39%	1,638,960	2,277,458
Profit (Rp billion)	0.71	1.19	0.48	67%	81,965	136,994
PAR > 30 days (Rp billion)	0.214	0.167	-0.047	-22%	24,740	19,306
PAR > 30 days (%)	1.51%	0.85%	-0.66%	-44%		
Income (Rp billion)	2.69	4.33	1.64	61%	310,867	500,694
Loan interest income (Rp billion)	2.60	3.66	1.06	41%	301,041	423,237
Cost of fund (Rp billion)	0.70	1.35	0.65	92%	81,387	155,954
Operational cost (Rp billion)	1.15	1.84	0.69	61%	132,370	212,486
Average loan portfolio (ALP)	10.49	16.94	6.44	61%	1,213,180	1,958,209
Long term debt (Rp billion)	14.00	20.73	6.73	48%	1,618,498	2,396,880
Average Equity (Rp billion)	4.26	4.94	0.68	16%	492,833	570,896
Average Assets (Rp billion)	14.95	23.95	9.00	60%	1,728,209	2,768,903

RATIOS	2001	2002	Var (unit)	% Var
INCOME/A L P	25.62%	25.57%	0%	0%
INTEREST INCOME/A L P	24.81%	21.61%	-3%	-13%
COF/INCOME	26.18%	31.15%	5%	19%
COF/A L P	6.71%	7.96%	1%	19%
OC/INCOME	42.58%	42.44%	0%	0%
OC/ALP	10.91%	10.85%	0%	-1%
ROA	4.74%	4.95%	0%	4%
ROE	16.63%	24.00%	7%	44%
DER	328.41%	419.85%	91%	28%

OUTREACH - BPR REGULAR	2001	2002	Var (unit)	% Var	In US Dollar	
					2001	2002
#BPR	42	44	2.00	5%		
# Borrowers @ BPR	46,816	57,396	10,580.00	23%		
# Savers @ BPR	123,644	141,878	18,234.00	15%		
Loan portfolio (Rp billion)	129.73	191.02	61.29	47%	14,997,696	22,083,249
Savings (Rp billion)	86.35	119.81	33.46	39%	9,982,896	13,851,337
Avg loan (Rp thousands)	2,711	3,328	617.11	23%	313	385
Avg savings (Rp thousands)	698	844	146.49	21%	81	98
% women clients	38%	52%	14.0%	37%		
PAR > 30 days	6.0%	4.8%	-1.2%	-20%		

OUTREACH-KUSUMA	2001	2002	Var (unit)	% Var	In US Dollar	
					2001	2002
# BPR	5	5	0.00	0%		
# Kusuma group	84	232	148.00	176%		
# Members/Savers	1,749	4,776	3,027.00	173%		
# Borrowers	1,728	4,776	3,048.00	176%		
Loan portfolio (Rp million)	396	1,191	795.00	201%	45,780	137,688
Savings (Rp million)	48	230	181.50	378%	5,549	26,532
Avg Loan (Rp thousands)	229	249	20.21	9%	26	29
Avg Savings (Rp thousands)	27	48	20.61	75%	3	6
% women clients	100%	100%	0.0%	0%		
PAR > 30 days	0%	2.37%	2.4%	#DIV/0!		

Note:

Rp 8,650 = 1 USD

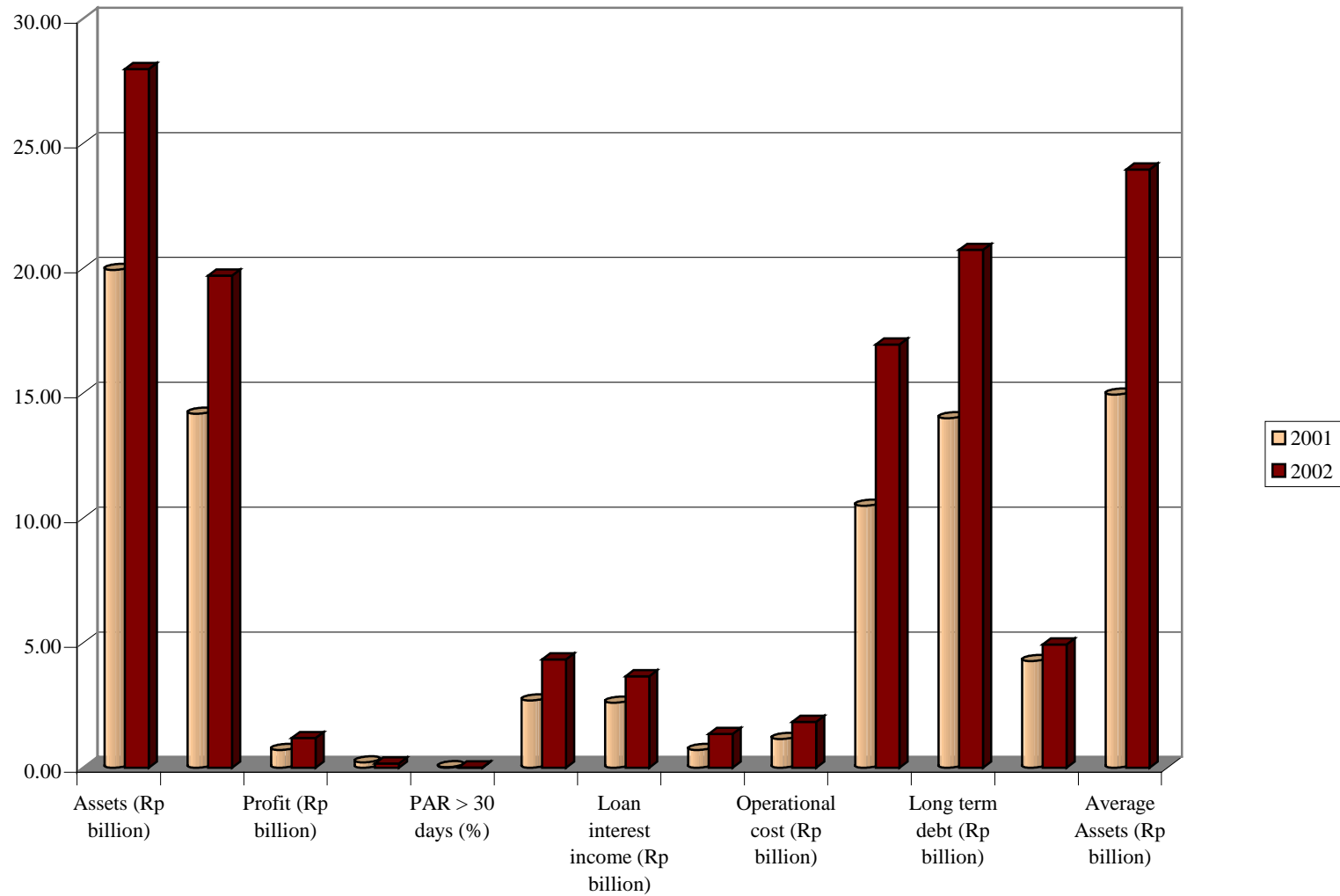
Rp 1 million = 115.6 USD

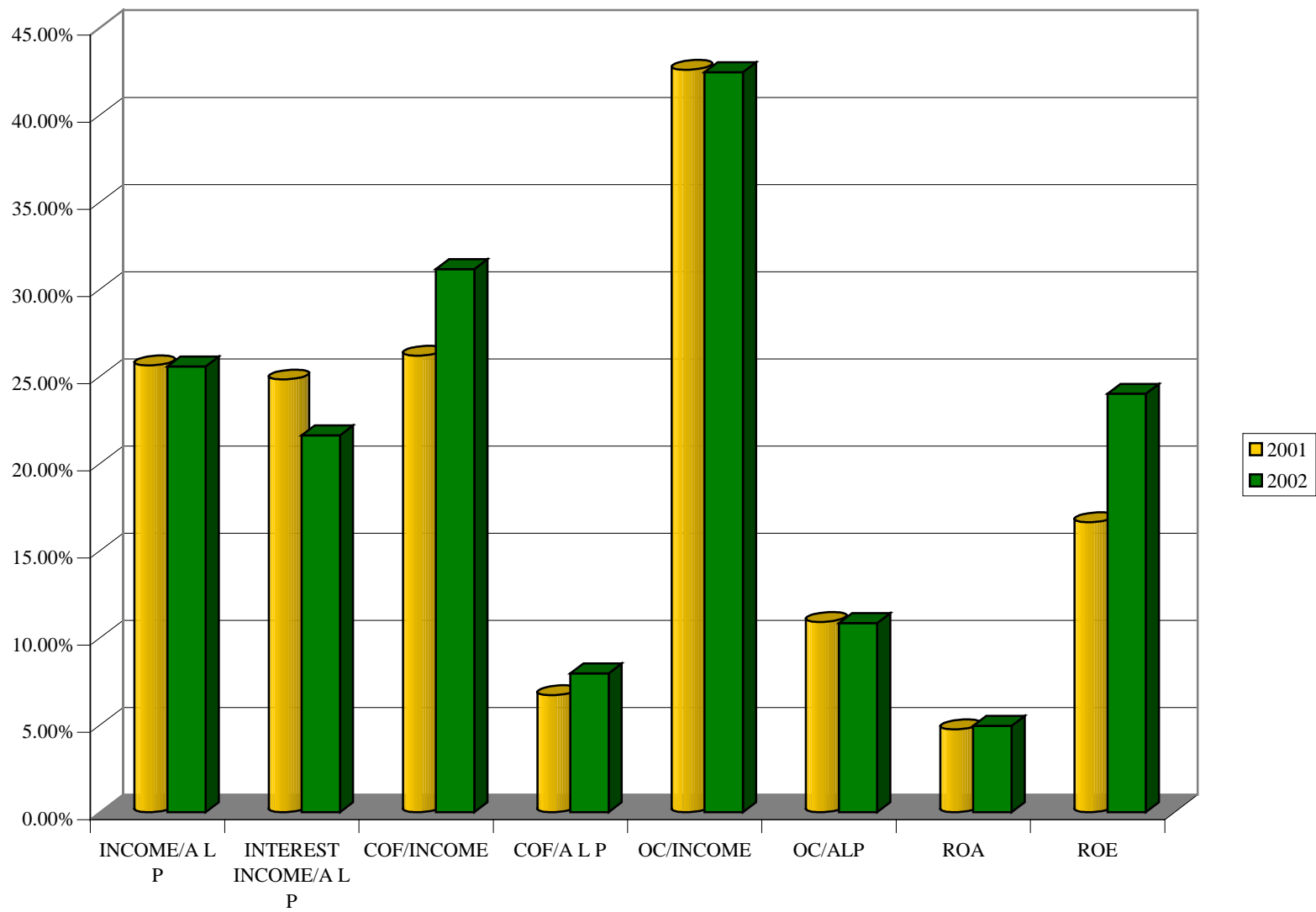
Rp 1 billion = 115,607 USD

ATTACHMENT 4

UKABIMA PERFORMANCE COMPARISON 2000 – 2001

FINANCIAL PERFORMANCE





ATTACHMENT 5

Ukabima Family Indicators

I. Social and Financial Indicators	September 30, 2002
---	---------------------------

Total BPRs	41
Total borrowers	51,470
Total savers	130,511
% women	40% ¹
Average loan size	363
Arrears >90 days	4%
Arrears >180 days	2%

II. Financial Indicators (in \$US)	
---	--

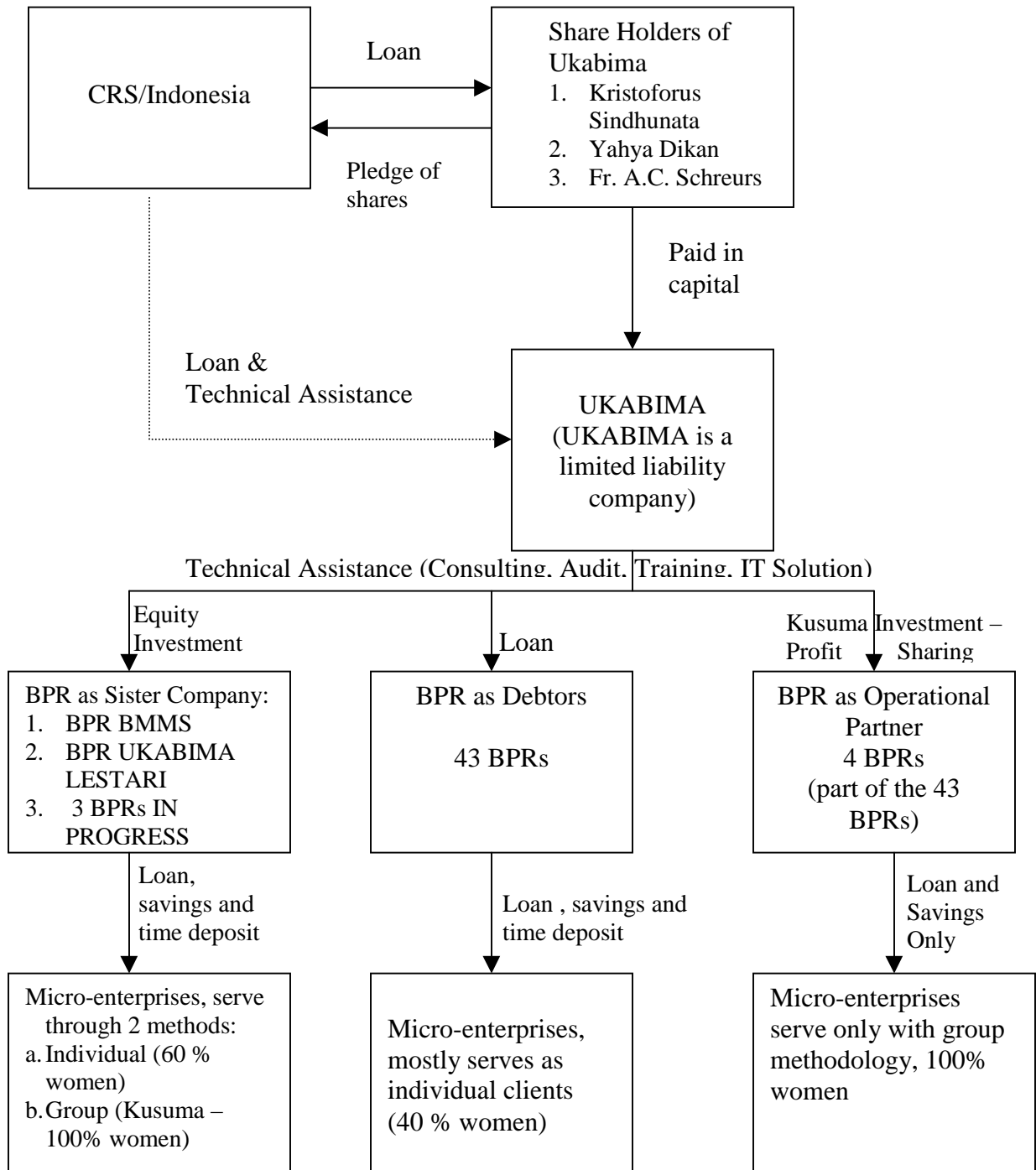
Consolidated loan portfolio	18.6 mn
Consolidated savings + time deposits	11.5 mn
Consolidated profit	0.8 mn
Consolidated net worth	3.0 mn
Consolidated return on equity (annual basis)	36%

Source: Consultant's report

¹ Note that in Indonesia deeds and titles to land and houses, which are the typical loan collateral, is generally in the name of the husband, and the account name will be that of the collateral owner. Therefore, this figure may not represent the true loan holder, which is more likely to be female than male.

ATTACHMENT 6

CRS MICROFINANCE WORKING SCHEME WITH BPRs THROUGH UKABIMA



ATTACHMENT 7

UKABIMA'S AVERAGE BPR PERFORMANCE

For the period 2001-2002

Indicator	Region			
	Bali	W. Java	C. Java	E. Java
DER	585	302	511	357
ROE	31.7	19.3	47.4	47.4
ROA	4.4	4.4	5.8	7.6
Inflation rate	10	10	10	10

The above figures show that the BPRs pay a cost of funds above the inflation rate, thereby offering decent premium to savers/depositors.

Source: Ukabima Headquarters, Jakarta, 2003

ATTACHMENT 8

SUMMARY OF UKABIMA QUESTIONNAIRE

1 Age of BPR

< 3 years	0
3 - 5 years	1
> 5 - 10 years	13
> 10 years	6

2 The Size of BPR

Jumlah Rp	Assets	Portfolio	Saving Time Deposit	Capital
<500 million			2	13
0.5 - 1 billion	1	3	12	8
>1 - 5 billion	20	18	2	0
>5 - 10 billion	2	2	7	2
> 10 billion				

3 The area of business that BPR currently services

Clients	> 50%	<30 - 40%	>10 - 30%	< 10%
Petty Trading	9	9		
Agriculture (incl. Animal Husbandry)	3	5	5	4
Home Industry	0	2	8	6
Other Services	0	1	11	4
Consumption & Other	1	1	4	13

ATTACHMENT 8

SUMMARY OF UKABIMA QUESTIONNAIRE

4	Sources of Funds	1	2	3	4	5	6	7	8	9	10	11	12		
	Share holder	7	1	4	0	2	1	0	2	1	0	0	1		
	Savers	2	2	4	1	2	0	4	0	0	2	0	0		
	Depositors	3	5	2	3	0	4	0	2	1	0	0	0		
	Friends	0	1	1	0	2	5	1	3	2	2	0	0		
	Family	0	3	1	3	1	0	4	1	2	2	0	0		
	Holding/Parents Company	1	2	2	1	1	0	1	0	0	3	1	1		
	Commercial Bank	2	1	3	3	3	3	0	2	3	0	0	0		
	Central Bank	1	1	0	0	3	2	2	3	2	2	0	0		
	Other BPR	4	1	0	4	1	2	2	3	5	1	0	0		
	Other Financial Provider	0	5	3	3	3	1	2	0	1	0	0	1		
	Do Nothing	0	0	0	0	0	0	1	0	0	3	9	1		
	Do not know	1	0	0	0	0	0	0	0	0	0	3	10		

5	Name of Organization/Institution	1	2	3	4	5	6	7	8	9	10	11	12		
	Ukabima	7	3	6	4										
	PNM	11	4	4	5										
	Oicocredit		1		1	5	6	1							
	Yayasan Dabanas		7	5	3	3	2	1							
	KUK Kesra-BKKBN	1	0	3	4	5	3	1		2					
	Bank Mandiri/BRI/BNI	1	4	0	4	1	3	3							
	International Investment Company				1	2	0	9	1	2	1	0	1		
	Non Finance State owned Agency			1	0	2	3	3	6	1	1	1			
	Religious related Organization							1	2	8	3	1			
	Political related Organization							1	0	1	6	6	1		
	Ethnical related Organization							1	2	1	3	5	0		
	Others					1	0	2	0	1	0	0	7	1	
6	Reason for Consideration	1	2	3	4	5	6	7	8	9	10	11	12	13	14

ATTACHMENT 8

SUMMARY OF UKABIMA QUESTIONNAIRE

the answer no. 5															
Interest rate	9	5	2	1	2	0	0	1	0	0	0	0	0	0	0
Collateral	3	5	0	1	0	3	2	0	1	0	1	0	1	1	1
Training, Seminar, Workshop	1	4	3	2	3	2	3	0	0	0	1	1	0	0	0
Management Consultancy	1	0	5	3	0	2	1	3	1	0	0	1	0	1	1
Audit and Finance Consultancy	0	0	1	4	2	1	2	2	5	1	0	0	1	0	0
IT Consultancy	0	1	0	0	2	0	0	2	2	5	1	4	1	0	0
Exposure to Network of similar practitioner	0	2	0	2	2	2	0	1	1	2	5	1	1	1	1
The Lending Organization reputation	1	0	0	1	2	3	3	5	0	0	0	3	0	0	0
The officers of lending organization	0	0	0	0	1	1	2	0	2	1	3	2	5	0	0
Desperate (pressurize by short of liquidity)	4	1	2	1	1	1	1	2	1	1	1	0	0	0	0
Risk distribution (not to depend to one lender)	0	0	1	0	2	4	2	1	1	2	3	1	2	0	0
Term of the loan (particularly period & method of payment)	0	2	4	3	1	0	2	1	2	2	1	1	1	0	0
Access to new product s for BPR developed by the lending organization	1	0	0	1	2	1	3	0	1	2	1	2	3	0	0
Others	0	0	1	1	0	0	0	0	0	0	0	0	0	4	4

7	Service Factor	MUST	WANT
	Reasonable Interest Rate	6	2
	Term/period of loan	6	14
	Payment of principal at the end of term	5	10
	Payment of principal every .. Month	4	17
	Payment of interest up front	2	5
	Payment of interest at the end of term	3	10
	Payment of interest monthly	10	8
	Training for Management	10	10
	Training for Manager/Supervisor	11	8

ATTACHMENT 8

SUMMARY OF UKABIMA QUESTIONNAIRE

Training for Staff	8	11
Training for Board Member	3	14
Management Consult	11	7
IT Consult	7	9
Audit and Finance Consult	7	11
Potential to access for new product development	7	11
Easy Communication	15	4
Easy Payment Method	17	3
Participation in the Lending Organization	9	11
Respect from the Lending Organization	5	14
Visit of the Lending Organization	7	11
Attention and quick response of the Lending Organization to the problem you and your BPR face	13	6
Friendliness and respectful staff of the Lending Organization	12	8
Potential to get more loan	8	12
Other	1	1

8	Measurement Factor	0	10	20	30	40	50	60	70	80	90	100
	Reasonable Interest Rate	0	0	0	0	3	2	5	2	5	0	2
	Term/period of loan	0	0	0	1	1	1	0	5	3	1	6
	Payment of principal at the end of term	0	0	0	1	0	3	1	5	2	1	8
	Payment of principal every .. Month	0	0	0	0	0	1	1	3	1	3	5
	Payment of interest up front	0	0	0	0	0	1	2	0	1	2	1
	Payment of interest at the end of term	0	0	0	0	0	2	3	0	3	1	2
	Payment of interest monthly	0	1	0	0	0	1	2	2	5	1	6
	Training for Management	0	0	1	0	0	0	1	1	5	4	6
	Training for Manager/Supervisor	0	0	1	0	0	0	0	2	3	4	5

ATTACHMENT 8

SUMMARY OF UKABIMA QUESTIONNAIRE

Training for Staff	0	0	1	0	1	0	0	4	4	2	5
Training for Board Member	0	0	0	1	0	1	2	0	4	0	2
Management Consult	0	0	0	1	0	1	2	0	9	1	3
IT Consult	0	0	0	1	0	1	0	2	5	2	3
Audit and Finance Consult	0	0	0	1	0	1	1	0	5	4	0
Potential to access for new product development	0	1	0	0	1	0	0	2	4	4	6
Easy Communication	0	1	0	0	0	1	0	3	4	3	8
Easy Payment Method	0	1	0	0	0	0	0	3	5	1	8
Participation in the Lending Organization	0	0	0	0	1	0	1	3	6	2	6
Respect from the Lending Organization	0	0	0	0	0	1	2	1	4	6	4
Visit of the Lending Organization	0	0	0	0	0	0	4	1	3	5	5
Attention and quick response of the Lending Organization to the problem you and your											
BPR face	0	0	0	0	0	0	2	2	2	4	6
Friendliness and respectful staff of the Lending Organization	0	0	1	0	0	0	1	1	3	3	9
Potential to get more loan	0	0	0	0	0	0	0	2	3	2	7
Other	0	0	0	0	0	0	0	0	0	0	0

ATTACHMENT 9

PT UKABIMA'S RECOMMENDATIONS FOR AND CALCULATION OF FINANCIAL SUSTAINABILITY MEASURES FOR BPRs

By Rudy Prasetya, Director of PT Ukabima

Based on the BPR model, where the initial focus is financial self-sustainability, we recommend that any MFI following the BPR approach should reach FSS level 3 by 2nd - 3rd year. It is important to reach this point in 2-3 years, because the BPR will not yet focus on outreach to a large number of clients. If the BPR is not able to reach FSS level 3 in 2-3 years then it is not feasible to start shifting its focus toward more risky customers (the poorest and agricultural customers), because once the BPR starts to expand its outreach to this type of clientele, there will be slower cash flow, and it will need a high volume of clients to compensate for the small loan size per borrower. The BPR is much more likely to be able to survive without any subsidy if FSS level 3 has been reached early in its operations.

This approach is based on Ukabima's experience with the BPR model. It may generate a lot of debate, because the more common practice is for MFIs to focus on both financial sustainability and outreach to the poorest, starting from the first day of operations. As we all know, the BPR model does not require any subsidy, even from the beginning of operations, just sufficient capital (US\$55,000) to operate. The BPR should get the rest of the funds required to operate from the market (loans, time deposits and savings). However, the BPR usually will only serve 400 - 700 borrowers and about 1000 - 1500 savers in the first 2-3 years. Growth in outreach (number of borrowers and savers) usually occurs after the BPR becomes profitable ($ROE > 20\%$ at the level of inflation 10%), which is generally earlier for BPRs than it is for other types of MFIs.

The following are the ratios we use to calculate financial sustainability:

FSS level 1 = (operating income/operating expenses)

FSS level 2 = (operating income/(operating expenses+cost of fund))

FSS level 3 = (operating income/(operating expenses+cost of funds+provision for bad debt))

FSS level 4 = (operating income/(operating expenses+cost of fund+provision for bad debt+capital or grant adjustment))

BIBLIOGRAPHY

Aghevli, Bijan B. "The Asian Crisis: Causes and Remedies." *Finance and Development* 36:2 (June 1999).

Asian Development Bank. *Key Indicators 2002: Population and Human Resource Trends and Challenges*. Asian Development Bank, 2002. 6 May 2003.
<http://www.adb.org/documents/books/key_indicators/2002/rt18.pdf>

Cerra, Valerie and Sweta Chaman Saxena. "Contagion, Monsoons, and Domestic turmoil in Indonesia: A Case Study in the Asian Currency Crisis." IMF Working Paper, WP/OO/60 (March 2000).

Child Survival and Health Database. UNICEF. 10 April 2003.
<<http://www.childinfo.org/eddb/health.htm>>

Conroy, John D. "Indonesia." *The Role of Central Banks in Microfinance in Asia and the Pacific: Indonesia*. 92-125.

Couet, Alka. E-mail correspondence. March-April 2003.

De Capele, Edmond. E-mail correspondence. April 2003.

Enoch, Baldwin, et al. "Indonesia: Anatomy of a Banking Crisis - Two Years of Living Dangerously 1997-99." IMF Working Paper, WP/01/52 (May 2001).

Fruin, Thomas Anthonij. *History, Present Situation and Problems of the Village Credit System (1897-1932)*, 1933. Reprint and translation: Klaas Kuiper, The Hague, Netherlands: Ministry of Foreign Affairs, Development Cooperation Department, 1999.

---. *Provisional Manual for the Credit Business of the General Popular Credit Bank*. 1935. Jakarta: General Popular Credit Bank. Reprint and Translation: Klaas Kuiper. The Hague, Netherlands: Development Cooperation Information Department of the Ministry of Foreign Affairs, 2000.

International Monetary Fund. *Indonesia: Statistical Appendix*. IMF Staff Country Report No. 00/133 (October 2000). Washington: International Monetary Fund

Maternal Health Database. UNICEF. 10 April 2003.
<<http://www.childinfo.org/eddb/maternal.htm>>

Microfinance Case Studies, Indonesia: Indonesia's Rural Financial System: The Role of the State and Private Institutions.

Pangestu, Mari and Manggi Habir. "The Boom, Bust, and Restructuring of Indonesia Banks." IMF Working Paper, WO/02/66 (April 2002).

Pratseya, Rudy. E-mail correspondence. March-May 2003

PT Ukabima. *Ukabima Annual Report*, 2002.

Ravicz, R. Marisol. *Searching for Sustainable Microfinance: A Review of Five Indonesian Initiatives*. Rural Cluster Development Economics Research Group.

Reille, Xavier. Telephone interview. 10 May 2003.

Robinson, Marguerite S. *The Microfinance Revolution, Volume 2: Lessons from Indonesia*. Washington: IBRD/The World Bank, 2002.

Schmit, Leo. *A History of the "Volkscredietwezen" (Popular Credit System) in Indonesia: (1895-1935)*. 1994. Reprint (ed.: Klaas Kuiper) The Hague, Netherlands: DVL/OS, 1999.

Siebel, Hans Dieter, and Uben Parhusip. *Microfinance in Indonesia: An Assessment of Microfinance Institutions Banking with the Poor*. Economics and Sociology Occasional Paper No. 2365. Ohio: The Ohio State University, 1998.

Singh, Anoop. "Indonesia: The Challenge of Sustaining the Economic Recovery." Presentation by the International Monetary Fund at the University of Indonesia, 50th Anniversary Conference, 4 October 2000.

United States Central Intelligence Agency. "Indonesia." *CIA World Factbook 2002*. Washington, DC, 2002. 10 April 2003.
<<http://www.cia.gov/cia/publications/factbook/geos/id.html>>